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Date: 6th October2014

Dear Fellow Investors,

Below is the performance of the Moats & Special Situations Portfolio (MSSP) as of 30th September 2014.

Portfolio Performance	Equity Allocation as on 30.09.2014	Equity Returns	Total Portfolio Returns After Expenses	Benchmark Returns
Since Inception (annualised)		28.8%	18.5%	8.4%
September Quarter	~70%	8.2%	5.8%	2.8%
1st April 2014 - 30th September 2014		46.6%	29.7%	28.6%

• Benchmark returns are based on BSE 500 and BSE Mid Cap in equal weight.
• Equity allocation mentioned above is for older accounts.
• Returns are cash flow adjusted and time (Daily) weighted returns after expenses.
• The actual returns of clients may differ from client to client due to different portfolio and timing of investment.
• Past performance is not guarantee for future performance.
• Inception Date is 27th January 2011.

The Nifty continues to hit new highs, but as is usually the case that does not tell the entire story of the equity markets. The Small Cap Index and the Mid Cap Index (both near, but not yet above their 2008 highs) have virtually doubled since August 2013, when pessimism was at its peak in the small & mid cap space. We had written about this topic in our earlier newsletters and how we were constructing our portfolio with a pronounced tilt to that sector. The steepness of the rally since has been more pronounced in the cyclical stocks that were our preferred segment.

Post-Elections, Indian markets have been primarily driven by –

- An apparent increasing appetite for risk, in the mistaken belief that higher risk asset classes imply higher "prospective" return.
- Early signs of an economic turnaround after a 5 year prolonged growth slowdown.
- Retail investors coming back to the market after a gap of nearly six years; celebrated with the highest single monthly net inflow in Equity Mutual funds seen post the January 2008 peak.
- The primary (IPO) market coming back to life with large oversubscriptions for new issues and strong gains on listing.

These are all signs that investors have moved from pessimism to a bullishness bordering on complacency. The extent of this complacency can be gauged by our estimates that markets have started to price in 2017 earnings to justify valuations for cyclical businesses which have just started to show signs of bottoming out or some signs of improvement. This is a phenomenon that we have experienced throughout market cycles mainly with small and midcaps wherein, during bear markets they are priced really "cheap" and during bull markets they are valued at very "rich" valuations.

Back to the basics: Finding your "edge" as an investor.

There are 3 key elements that give an "edge" to an investor over other market participants–Information, Process & Behavior.

Information edge is the possession of more information about a company quicker than others either by meeting management, through channel checks, meeting suppliers, customers and competitors, etc. This does not necessarily mean inside information. But there are 4 issues with trying to develop solely an

Prepared for Restricted Circulation

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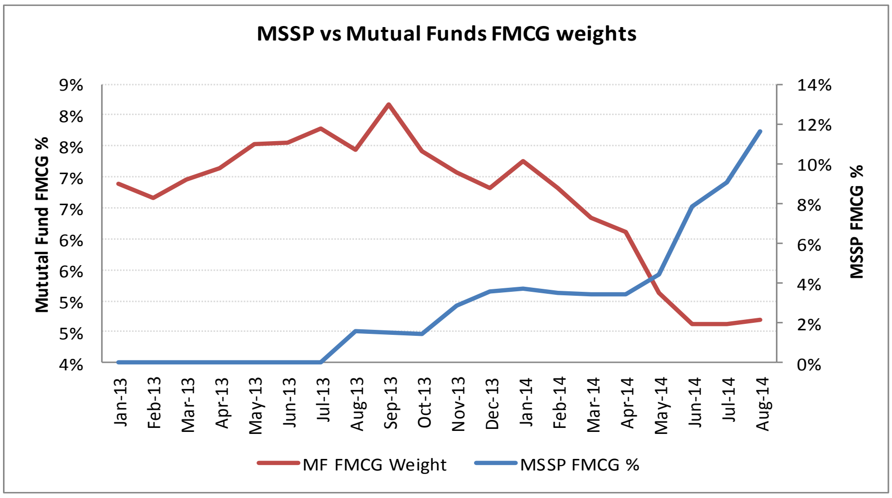
information edge – 1. It is difficult to replicate over time as it depends on the availability of "differentiated" information. 2. What one sees as information may in fact be "noise" and could have already been incorporated in the structure of prices 3. Technology has helped bring down both the cost and time to gather information; which is in many cases, widely disseminated over the internet and hence has led to a diminishing information edge and finally, 4. Regulators and companies are more sensitive about ensuring a level playing field between institutional and retail investors in getting the relevant information in the public domain as quickly as possible.

We define a Behavioral edge when an investor is able to control his emotions by eschewing either greed or fear and is conversely able to exploit these twin emotions of other market participants in his favor. We believe a behavioral edge can be more easily developed by having a sound investment process and having the confidence to follow that investment process. We believe a "process driven" behavioral edge that benefits from the mood swing of market participants is a sustainable edge as human behavior has been ingrained in our DNA, our "wiring" as Buffett calls out, over millions of years.

Markets movements have an uncanny ability to distort the vision of an investor. In a bull market as market prices go up, the downside risk keeps getting blurred and there arrives a point at which the only parameter visible to the investor is the upside potential. In the current market, certain pockets (especially in the cyclical space) have reached a point where investors seem to be completely driven by the potential upside and are willing to fully factor positive outcomes into the future, while completely ignoring the probability of a negative outcome which could prove to be a much bigger risk on the downside. We feel it is extremely difficult, if not impossible, to predict a particular outcome based on a particular narrative (for example in the current context that economic growth will revive) that sounds plausible but has uncertain implications for market process of specific companies. A process driven investment approach therefore, can help an investor avoid behavioral traps, have a clearer roadmap as to what action to take and thus on average take more correct than incorrect decisions.

In the current environment market participants have shifted their focus to buying cyclical companies. But by sticking to our process (weighing both reward and risk) we have actually been lightening our holdings in this space. *We would rather risk under-performance than a "permanent loss of capital"*. We have accordingly been shifting our portfolio weights to FMCG stocks which generally get neglected by market participants in such a phase of the market. The adjacent chart *(Refer Figure 1)* shows how Mutual Funds have pared their exposure to the FMCG sector (there appears to be some renewed interest of late though) that led to better reward-risk ratios giving us an opportunity to enter the FMCG sector.

Figure 1: MSSP vs Mutual Funds FMCG Weights



Source: MF sector allocation data from SEBI. The chart is as of 31 Aug 2014. The scales have been taken separately to give a better perspective of the quantum of reduction done by MFs vs the addition in MSSP.

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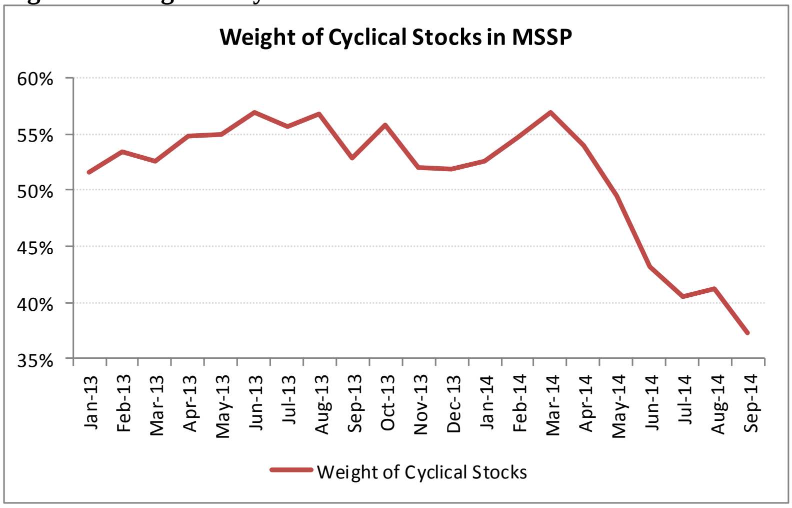
Asset Allocation:

Our overall equity weight has gone from 60%+ to around ~70%. But the key point to note is that the incremental weights have all been in the non-cyclical space. Weights in cyclical stocks have reduced *(Refer Figure 2)*, as some of the cyclical stocks have already factored in a complete recovery of the cycle.

Figure 2: Weight of Cyclical Stocks in MSSP



Another point to highlight is with respect to the change in exposure based on market capitalisation since the August 2013 bottom. As can be seen in the table below*(Refer Figure 3)*, at the bottom of the market we had around 30% exposure to small capitalisation companies, where we were able find small High Quality cyclical companies at a reasonable margin of safety (discount to intrinsic value). The small cap index has since more than doubled. With prospective returns diminishing substantially, our exposure to the small capitalisation companies has now come down to only 9%, for reasons already mentioned with reference to cyclical stocks.

Figure 3: Portfolio exposure based on Market Capitalisation

Indices	Return of Indices since August 2013 Bottom	Equity Allocation (based on Market capitalisation)	
		Our portfolio weights then (Aug 2013 Bottom)	Our portfolio weights now (30 Sep 2014)
NIFTY (Large Cap)	51%	37%	51%
BSE Midcap	82%	33%	40%
BSE Smallcap	108%	30%	9%

Note: The Market caps of August 2013 have been used for Sep 2014 as well, to make it more comparable i.e. to see like to like shift. If current Sep 2014 Market caps would have been used the small cap exposure would have been much lower as some of these stocks would have migrated to Midcaps and some Midcaps to large caps purely on account of price appreciation.

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Figure 4: Business Model and Sector Allocation:

Moat/Limited Moat	Sep-13	Dec-13	Mar-14	Jun-14	Sep-14
Moat	33%	37%	33%	32%	40%
Limited Moat	43%	42%	45%	42%	36%
Moat + Limited Moats	***76%***	***79%***	***78%***	***74%***	***76%***
No Moat	13%	10%	12%	14%	13%
Regulated Utility	11%	11%	11%	12%	12%
Grand Total	**100%**	**100%**	**100%**	**100%**	**100%**

Sectors	Sep-13	Dec-13	Mar-14	Jun-14	Sep-14
FMCG	2%	5%	5%	13%	20%
Auto & Auto Ancs	19%	20%	24%	21%	20%
Financials & Financial Services	25%	20%	21%	19%	16%
Industrials	13%	19%	20%	21%	14%
Utility	13%	11%	11%	12%	12%
Information Technology	3%	-	-	3%	7%
Telecom	3%	4%	4%	3%	4%
Capital Goods	10%	10%	9%	8%	3%
Pharma	7%	5%	-	-	3%
Logistics	4%	5%	6%	-	-
Other	2%	2%	2%	-	-
Grand Total	**100%**	**100%**	**100%**	**100%**	**100%**

Needless to say, none of these changes in the structure and composition of the portfolio is on account of a “gut” feeling, but are based purely on the bottom up idea generation process that we follow that gives us a continuous index of the reward-risk ratio on the stocks we follow.

Portfolio Activity during the quarter:

In the past quarter we have increased our weights across what is regarded as defensive stocks such as the FMCG & IT sectors.

KSB Pumps is a good example of a cyclical business which we had bought at the bottom of the cycle. In spite of being a good business, we exited the stock recently since in our view the stock price was factoring in the bulk of a cyclical recovery that had yet to begin. We are quite mindful when it comes to paying for uncertain events, which in this case is the actual change in capex cycle at the ground level.

We took an initiating position in another FMCG company which is mainly in the cigarette business. The company is one of the most profitable Cigarette companies in the world. We would look to add more in this company when we get opportunity at lower levels.

Regards,
Jinal Sheth
Portfolio Manager

Rohan Samant
Asst. Portfolio Manager

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Statutory Details: Portfolio Manager – Multi-Act Equity Consultancy Private Limited

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Risk factors

General risk factors

a. Securities investments are subject to market risks and there is no assurance or guarantee that the objective of the investments will be achieved.

b. Past performance of the Portfolio Manager or its affiliates does not indicate its future performance.

c. Investors are not being offered any guaranteed or assured returns i.e either of principal or appreciation on the Portfolio.

d. As with any investment in securities, value of the Client's Portfolio can go up or down depending on the factors and forces affecting the capital market.

e. The Portfolio Manager is neither responsible nor liable for any losses resulting from the operations of the Portfolios.

f. The investments made are subject to external risks such as war, natural calamities, and policy changes of local / international markets which affect stock markets.

g. The Portfolio Manager has renewed SEBI PMS registration effective October 14, 2011 and has commenced its portfolio management activities with effect from January 2011. However the Portfolio Manager has more than 10 years of experience in managing its own funds invested in the domestic market.

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